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In The

Supreme Court of the United States

October Term, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Petitioners,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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QUESTION PRESENTED

Where Congress has declared that natural gas local distribution companies are subject only to state regulation, may the Federal Energy Regulatory Commission assert control over the allocation and sale of capacity rights by those companies to consumers within the state?

PARTIES TO THE PROCEEDING

The parties to the proceeding below were:

Federal Energy Regulatory Commission (Respondent)

Alabama Gas Corporation (Intervenor)

Algonquin Gas Transmission Company (Intervenor)

Allied Signal Inc. (Intervenor)

American Forest & Paper Association (Petitioner)

American Public Gas Association (Petitioner)

Amoco Production Company (Intervenor)

Anadarko Petroleum Corporation (Intervenor)

ANR Pipeline Company (Intervenor)

Arcadian Fertilizer (Petitioner)

Arco Natural Gas Marketing (Intervenor)

Arco Oil & Gas Company (Intervenor)

Arizona Electric Power Cooperative Inc. (Petitioner)

Arizona Public Service Company, *et al.* (Petitioner)

Asarco, Inc., Cyprus Miami Mining Corporation, and Magma Copper Company (Petitioner)

Associated Gas Distributors (Petitioner)

Associated Natural Gas Company (Petitioner)

Atlanta Gas Light Company (Petitioner)

Baltimore Gas & Electric Company (Petitioner)

Bay State Gas Company, *et al.* (Intervenor)

Board of Water, Gas & Light Commissioners, Albany, Georgia (Intervenor)

Brooklyn Union Gas Company (Intervenor)

Canadian Association of Petroleum Producers, *et al.* (Intervenor)

Carnegie Natural Gas Company (Petitioner)

Chattanooga Gas Company (Petitioner)

Cascade Natural Gas Corporation (Intervenor)

Chevron, U.SA, Inc. (Intervenor)

Cincinnati Gas & Electric Company, *et al.* (Intervenor)

Citizens Gas & Coke Utility (Petitioner)

City of Hamilton, Ohio (Petitioner)

CNG Transmission Corporation (Petitioner)

Colorado Interstate Gas Company (Petitioner)

Colorado Springs Utilities (Petitioner)

Columbia Gas Distribution Companies (Intervenor)

Columbia Gas Transmission Corporation (Intervenor)

Conoco, Inc. (Intervenor)

Consolidated Edison Company of New York, Inc. (Petitioner)

Dakota Gasification Company (Intervenor)

Dayton Power & Light Company (Intervenor)

Destec Energy, Inc. (Intervenor)

East Ohio Gas Company, *et al.* (Intervenor)

East Tennessee Group (Petitioner)

East Tennessee Natural Gas Company (Intervenor)

Elizabethtown Gas Company, an Operating Division of NUI Corporation (Petitioner)

El Paso Natural Gas Company (Intervenor)

Enron Oil & Gas Marketing, Inc. (Intervenor)

Enserch Development Corporation (Petitioner)

Equitrans, Inc. (Petitioner)

Exxon Corporation (Intervenor)

Florida Cities (Intervenor)

Florida Gas Transmission Co. (Intervenor)

Foothills Pipelines Ltd. (Intervenor)

Fort Pierce Utilities Authority and the City of Vero Beach, Florida (Intervenor)

Fuel Managers Association (Intervenor)

Georgia Industrial Group (Petitioner)

Great Lakes Transmission Ltd. (Intervenor)

Hadson Gas Systems, Inc. (Petitioner)

Illinois Commerce Commission (Petitioner)

Illinois Power Company (Petitioner)

Indiana Gas Company (Petitioner)

Interstate Natural Gas Association of America (Intervenor)

Joint State Commissions and Consumer Advocates (Petitioner)

KN Energy, Inc. (Intervenor)

Kern River Gas Transmission Company (Petitioner)

Koch Gateway Pipeline Company (Petitioner)

Laclede Gas Company (Petitioner)

Long Island Lighting Company (Petitioner)

Louisville Gas & Electric Company (Petitioner)

Maryland Office of People's Counsel (Petitioner)

Maxus Exploration Company and Maxus Gas Marketing Company (Intervenor)

Memphis Light, Gas and Water Division (Petitioner)

Meridian Oil Inc. (Petitioner)

Michigan Consolidated Gas Company (Intervenor)

Midland Cogeneration Venture Limited (Petitioner)

Minnesota Public Utility Commission and Minnesota Department of Public Service (Intervenor)

Mississippi River Transmission Corporation (Intervenor)

Missouri and Kansas Gas Users (Intervenor)

Missouri Public Service Commission, *et al.* (Petitioner)

Mitchell Energy Corporation (Intervenor)

Mobile Gas Service Corporation, *et al.* (Intervenor)

Mobile Natural Gas, Inc. (Intervenor)

Montana Public Service Commission, Public Utilities Commission of South Dakota and Montana Consumer Counsel (Petitioner)

Mountaineer Gas Company (Petitioner)

National Association of State Utility Consumer Advocates (Petitioner)

National Association of Gas Consumers (Intervenor)

National Fuel Gas Supply Corporation (Intervenor)

Natural Gas Clearinghouse (Intervenor)

Natural Gas Pipeline Company of America (Intervenor)

New Jersey Board of Regulatory Commissioners (Petitioner)

New Jersey Natural Gas Company (Petitioner)

New York State Electric & Gas Corporation (Intervenor)

New England Power Company (Petitioner)

Northern Indiana Public Service Company (Petitioner)

Niagara Mohawk Power Corporation (Petitioner)

Noram Energy Corporation (Petitioner)

North Carolina Natural Gas Company and Public Service Commission of North Carolina (Intervenor)

Northeast Energy Associates and New Jersey Energy Associates (Intervenor)

Northern Border Pipeline Company (Intervenor)

Northern Distributor Group (Intervenor)

Northern States Power Company (Minn.), *et al.* (Intervenor)

Northern Natural Gas Company, *et al* (Intervenor)

Northwest Alaskan Pipeline Company (Petitioner)

Ocean State Power, *et al.* (Petitioner)

Office of the Consumers' Counsel, State of Ohio (Petitioner)

Orange and Rockland Utilities, Inc. (Petitioner)

Ozark Gas Transmission System (Petitioner)

Pacific Gas & Electric Company (Petitioner)

Pacific Interstate Transmission Company, *et al.* (Intervenor)

Pan-Alberta Gas, Ltd. (Intervenor)

Panhandle Customer Group (Intervenor)

Panhandle Eastern Pipe Line Company (Intervenor)

Panhandle Trading Company (Intervenor)

Pennzoil Exploration & Production Company and Pennzoil Gas Marketing Company (Intervenor)

PEPCO Energy (Petitioner)

Pennsylvania Office of Consumer Advocate (Petitioner)

Pennsylvania Public Utility Commission, *et al.* (Petitioner)

Peoples Gas System, Inc. (Intervenor)

Peoples Natural Gas Company (Petitioner)

Piedmont Natural Gas Company (Petitioner)

Philadelphia Electric Company (Petitioner)

Phillips Petroleum Company, *et al.* (Intervenor)

Plains Petroleum Operating Company (Petitioner)

Process Gas Consumers Group, *et al.* (Intervenor)

Producer-Marketing Transportation Group (Petitioner)

ProGas, Ltd. (Petitioner)

Public Service Commission of the Commonwealth of Kentucky (Petitioner)

Public Service Commission of Nevada (Intervenor)

Public Service Commission of the State of New York (Petitioner)

Public Service Commission of West Virginia, Consumer Advocate Division (Petitioner)

Public Service Commission of Wisconsin (Petitioner)

Public Service Electric & Gas Company (Intervenor)

Public Utilities Commission of the State of California (Petitioner)

Rochester Gas & Electric Company (Intervenor)

Shell Gas Trading Company (Intervenor)

South Jersey Gas Company (Intervenor)

South Carolina Pipeline Corporation (Intervenor)

Southern Natural Gas Company (Intervenor)

Southwest Gas Corporation (Petitioner)

State of Louisiana (Petitioner)

State of Indiana, Office of Utility Consumer Counselor (Petitioner)

Tenneco Gas, Inc. (Intervenor)

Tennessee Gas Pipeline Company (Intervenor)

Tennessee Small General Service and Columbia Small Customer Group (Intervenor)

Tennessee Valley Municipal Gas Association (Petitioner)

Texaco, Inc. (Intervenor)

Texas Eastern Transmission Corporation, *et al.* (Intervenor)

TransCanada Pipelines Limited (Intervenor)

Transcontinental Gas Pipe Line Corporation (Intervenor)

Transwestern Pipeline Company (Intervenor)

Trunkline Gas Company (Intervenor)

T.W. Phillips Gas & Oil Company (Intervenor)

UGI Utilities, Inc. (Intervenor)

Union Pacific Fuels, Inc. (Intervenor)

United Cities Gas Company (Intervenor)

United Distribution Companies (Petitioner)

Vastar Resources, Inc. and Vastar Gas Marketing, Inc. (Intervenor)

Virginia Electric & Power Company (Petitioner)

Washington Gas Light Company (Intervenor)

Williams Gas Marketing Company (Petitioner)

Williams Natural Gas Company (Petitioner)

Williston Basin Interstate Pipeline Company (Petitioner)

Windward Energy and Marketing Company (Intervenor)

Wisconsin Distributor Group (Petitioner)

CORPORATE DISCLOSURE STATEMENT

Petitioner Associated Gas Distributors (AGD) is a trade association incorporated under the laws of Delaware. The member companies of AGD are local natural gas distribution utilities. AGD does not have any parent companies or subsidiaries.

Petitioner Atlanta Gas Light Company (Atlanta) is a corporation organized and existing under the laws of the State of Georgia and is engaged primarily in the purchase, sale and distribution of gas within Georgia. Atlanta has no parent companies or subsidiaries (other than wholly-owned subsidiaries).

Petitioner Chattanooga Gas Company (Chattanooga) is a public utility engaged in the distribution of natural gas in the City of Chattanooga, Tennessee, and surrounding territory. Chattanooga is a wholly-owned subsidiary of Atlanta and has no subsidiaries.

Petitioner Northern Indiana Public Service Company (Northern Indiana) is a public utility incorporated in the State of Indiana and engages in supplying natural gas and electric energy to the public in the Northern third of Indiana. Northern Indiana is a wholly-owned subsidiary of NIPSCO Industries, Inc., an energy-based holding company.

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Associated Gas Distributors, Atlanta Gas Light Company, Chattanooga Gas Company, and Northern Indiana Public Service Company respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion and judgment of the Court of Appeals (reprinted in Pet. App. A) is reported at 88 F.3d 1105 (D.C. Cir. 1996), and was amended in relevant part on October 29, 1996 (reprinted in Pet. App. F). The orders of the Federal Energy Regulatory Commission, Orders 636, 636-A, 636-B, and 636-C (reprinted in Pet. App. B, C, D, and E, respectively) are reported at III FERC ¶ 30,939 (1992), III FERC ¶ 30,950 (1992), 61 FERC ¶ 61,272 (1992), and 62 FERC ¶ 61,007 (1993), respectively.

STATEMENT OF JURISDICTION

On July 16, 1996, the Court of Appeals affirmed in part and remanded in part the orders of the Federal Energy Regulatory Commission (FERC) known as Orders 636, 636-A, 636-B, and 636-C (collectively, Order 636). The Court of Appeals' July 16 opinion upheld the validity of the portion of Order 636 challenged by this Petition. On October 29, 1996, the Court of Appeals denied a timely petition for rehearing and suggestion for rehearing *en banc* submitted by certain of these Petitioners. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), provides:

> The provisions of this chapter shall apply

> to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 1(c) of the Natural Gas Act, 15 U.S.C. § 717(c), provides:

> The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction

over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

STATEMENT OF THE CASE

This case is about FERC's effort, in Order 636, to preempt state regulatory authority over "capacity sales" by state-regulated local distribution companies to end-user customers within the State. The portion of the Court of Appeals opinion addressing the issue is at 88 F.3d at 1148-53; Pet. App. A, 71a-82a, *as amended by* Pet. App. F, 1001a-1002a.[1] To understand the issue, and the flaws in the Court of Appeals' reasoning, it is necessary to provide some regulatory and historical background.

A. The Framework Of State And Federal Authority Under The Natural Gas Act

The natural gas industry is functionally separated into three segments: production, transportation, and distribution. Traditionally, a producer extracted natural gas from an underground reservoir and sold it to a pipeline company. The pipeline company then transported the gas and re-sold it to a local distribution company (LDC). The LDC, in turn, distributed the gas and sold it at retail to residential, commercial, and industrial gas consumers. 88 F.3d at 1122; Pet. App. A at 6a.

With the Natural Gas Act (NGA) of 1938, the Federal Power

1. An appendix containing the opinion of the court of appeals and opinions on rehearing, as well as the several, lengthy FERC orders that give rise to those opinions, is being filed jointly by the several petitioners for writ of certiorari of the court of appeals' decision. Citations in this Petition are to that appendix (Pet. App). The opinion below is also reported at 88 F.3d 1105 (D.C. Cir. 1996), although it does not include the amendment to the decision reflected in Pet. App. F. Parallel citations to the reported opinion are also used in the body of this Petition.

Commission, predecessor of the Federal Energy Regulatory Commission, was given authority over sales for resale in interstate commerce and over interstate transportation of gas, leaving regulation of local distribution and retail gas utility service to the States. 15 U.S.C. § 717(b). Federal authority was intended to fill a regulatory gap created by decisions of this Court under the "dormant Commerce Clause" precluding the States from regulating interstate transportation and wholesale sales of natural gas. *See* 88 F.3d at 1122, Pet. App. A, 7a; *see also Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377-80 (1983); *Panhandle Eastern Pipe Line Co. v. Pub. Serv. Comm'n of Indiana*, 332 U.S. 507, 514-21 (1947).

While the NGA assigned to a federal agency the role of filling the regulatory gap created by perceived constitutional limits on state power, all existing, state regulatory authority was preserved, free from federal intrusion. The NGA has from its inception expressly provided that neither the "local distribution" of natural gas nor the facilities used for such distribution were subject to the provisions of that law. 15 U.S.C. § 717(b).

Thus, the NGA contemplates a clear division of state and federal authority, with the States and the federal government occupying distinct regulatory spheres. The core, around which the federal government's authority filled in, was the traditional state authority over the relationship between local distribution companies and their in-state customers. The NGA "was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other." *Federal Power Comm'n v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513 (1949). The boundaries established by the NGA "take 'no authority from State commissions' and [are] 'so drawn as to complement *and in no*

manner usurp State regulatory authority.' " *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944) (emphasis added) (quoting H. Rep. No. 709, 75th Cong., 1st Sess. p. 2).

B. *FPC v. East Ohio Gas* And The 1954 Hinshaw Amendment

This "walling off" of the area of traditional state authority over local distribution and local distribution companies from federal intrusion was reinforced in 1954 with an amendment to the NGA. This amendment (the "Hinshaw amendment" or "Hinshaw exemption," 15 U.S.C. § 717(c)) now helps to define the limit of FERC authority and the scope of authority reserved to the States. It specifies that certain entities subject to state regulation are *exempt* from federal regulation. It specifically provides, *inter alia*, that the NGA "shall not apply to any person engaged in . . . the transportation in interstate commerce or the sale in interstate commerce for resale," provided that certain conditions are met, most notably the condition that the entity is subject to state regulatory authority. *Id.* "The matters *exempted* from the provisions of this [Act] . . . are hereby declared to be matters primarily of local concern and subject to regulation by the several States."[2] *Id.* (emphasis added).

The Hinshaw amendment was a congressional response to a decision of this Court. In *Federal Power Commission v. East Ohio Gas Company*, 338 U.S. 464 (1950), the Court examined the scope of federal authority under Section 1(b). Finding the power the FPC was exercising to fall within the terms of the

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2. The traditional regulation of LDC services to local consumers served a variety of purposes chosen by the state government as appropriate for its citizens. While these purposes generally included economic protection of consumers from the market power of a monopoly-like provider of a basic utility service, they also served a wide range of other objectives. *See Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 634-38 (1944).

portion of Section 1(b) describing the scope of federal power, the Court treated the portion of Section 1(b) that preserves traditional state authority as mere "surplusage." 338 U.S. at 470-71. If the regulation fell within the affirmative grant of authority to the FPC over a "'natural-gas company,' no state can interfere with federal regulation." 338 U.S. at 473.

The Court acknowledged that the NGA was intended to grant the federal government authority over *only* "those companies which states could not regulate." 338 U.S. at 471. The Court concluded, however, that in determining what the States could *not* regulate, it was necessary to refer to decisions of the Court immediately preceding enactment of the NGA. Those cases had taken an extremely broad view of the (dormant) Commerce Clause and thus a very narrow view of permissible exercises of state power. The Court held that the constitutional power reserved to the States by the NGA was to be defined under these "prior constitutional decisions" and *not* by the far broader power that the States were by then acknowledged to possess. 338 U.S. at 471-72.

Justices Jackson and Frankfurter dissented. 338 U.S. at 476. They emphasized that East Ohio Gas Company is "an all-Ohio company, deriving income solely from distributing gas directly to Ohio consumers," and that the "Ohio State Commission. . . . is able to supervise and regulate this utility completely and continuously." 338 U.S. at 477. In light of the common understanding that Congress sought "to complement and in no manner usurp State regulatory authority," *id.* at 479 (quoting *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. at 610), the dissenters would have held that the State's power over East Ohio Gas left no room for federal regulation. As to the notion that power reserved to the States was defined by prior cases rather than current law, the dissenters noted that the Court had *not* provided an accurate description of the Court's own prior rulings on the scope of the dormant Commerce Clause.

Moreover, the dissenters found no basis for believing that when Congress commanded respect for state authority under Section 1(b), it meant the scope of the States' constitutional authority as declared in prior cases, rather than that constitutional authority as it actually exists — at least, as currently understood. 338 U.S. at 480-81. The "gap" in state regulatory authority which the NGA sought to fill with federal power concerned the States' inability to regulate wholesale sales. 338 U.S. at 483. Because federal power was, at bottom, a gap-filler, the dissenters asserted that the scope of federal power could only be understood by first identifying the power that the States could constitutionally exercise and which Congress reserved to them.

With the Hinshaw amendment, Congress overrode the conclusion reached by the majority in *East Ohio Gas* and sought to restore the original understanding of the Act, as better reflected in the dissent. Section 1(c) of the NGA reserved *to the States* a distinct area of state regulatory authority. Thus, LDCs regulated by state commissions were declared *exempt* from the Act and off-limits to federal regulation.

Following enactment of the Hinshaw exemption, a large number of local distribution companies filed applications to the Federal Power Commission for declarations of exemption; such applications routinely were granted. Typically, the declarations of exemption included a finding that the local distribution company was subject to regulation by the State Commission and, as such, was "exempt from the provisions of the Natural Gas Act and the orders, rules and regulations of the Commission issued pursuant thereto." *See, e.g., Atlanta Gas Light Company*, 14 F.P.C. 1156, 1157 (1955).

Pursuant to these principles, FERC has historically regulated sales for resale of natural gas *to LDCs*; state commissions have regulated LDCs' natural gas sales and services within their local, intrastate market areas.

C. FERC's Restructuring Of Natural Gas Markets By Unbundling Pipeline Services

In Order 636, FERC acted to complete a process whereby the regulated services of interstate pipelines would be "unbundled" or "separated," changing the way that natural gas and related transportation and distribution services had historically been sold. "Unbundling" meant that natural gas would no longer be sold by pipelines to LDCs "as delivered" — with the costs of production, transportation and the gas itself bundled into the purchase price of the gas sold. Rather, pipelines would have to sell "transportation" separately. 88 F.3d at 1126; Pet. App. A, 16a-17a.

These FERC-promoted changes in the market structure required a shift in the traditional market role of pipelines and other industry participants. Pipelines, for example, generally withdrew from the gas sales business and became providers of transportation services only. LDCs and certain of their traditional customers began to acquire gas supplies directly from producers or marketers, rather than pipelines, and to arrange for transportation to their facilities.

As a result of their customers' access to separate, unbundled gas supplies, LDCs were also placed in the position of providing transportation of natural gas, rather than "bundled" gas sales, to certain of their traditional customers.[3] In lieu of their

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3. An October 24, 1996 report published by the American Gas Association under the title "Providing New Services to Residential Customers: A Summary of Pilot Programs and Unbundling Initiatives" contains the following introductory statement:

> Over the last several years, local distribution companies (LDCs) have offered customers behind the city-gate an increasing array of options and services.

(Cont'd)

traditional sales of gas, LDCs provided services to these in-state customers in the form of (1) local transportation service of the customers' gas through the LDCs' distribution system; *and* (2) assignment to customers of some portion of the LDCs' own upstream interstate pipeline service rights to be used to move

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(Cont'd)

> These services have included varying degrees of transportation, storage and balancing services as well as access to upstream pipeline capacity. These services have provided industrial and commercial customers with the opportunity to purchase supplies in the marketplace from a variety of suppliers. As a result, competition created in these markets has led to significant cost savings for the customer and efficiency improvements for the natural gas industry. . . .
>
> Providing unbundling services to the residential customer poses a host of questions for LDCs, state regulators, marketers looking to serve the residential market, as well as residential customers themselves. Issues such as designing and administering customer aggregation programs, developing new contractual relationships with marketers, potentially redefining the utility's obligation to serve and the resulting costs of that service and designing new balancing services must be considered. In addition, marketing rules and regulations, the allocation of upstream pipeline and storage capacity, and the collection/administration of social costs must be addressed in developing a residential transportation program.
>
> This issue brief has identified sixteen states where either residential pilot programs or broader customer choice programs are being implemented. Fourteen LDCs in ten states have developed residential pilot programs. These pilots, in aggregate, will provide customer choice to over 200,000 households.

the customers' gas from the gas seller's facilities to the LDCs' distribution system. This latter feature of LDC transportation service has come to be called an LDC's "capacity release" or "capacity assignment." Because it involves LDCs' gas service to their traditional in-state customers, it has been regulated by the state commissions.[4]

D. FERC's Assertion Of Jurisdiction Over LDCs' Capacity Sales In Order 636

As part of its overall assertion of authority over the "restructuring" of the natural gas industry, FERC's Order 636 declared that, in the situation described above, the LDC's release or assignment of some of its pipeline capacity rights to its local customer was subject to FERC's overall plan of controlling the sale and resale of pipeline capacity. Accordingly, FERC held that an assigning LDC should be issued a transportation certificate under NGA Section 7 and its charges for this capacity assignment should, *inter alia*, be controlled (not by state law, but rather) by a FERC-determined rate ceiling.

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4. *See, e.g.*, Report and Order in re: *In the Matter of Laclede Gas Company's Tariff Sheets* (Mo. PSC, Aug. 28, 1996); Order in re: *In the Matter of the Regulation of the Purchased Adjustment Clause Contained Within the Rate Schedules of the East Ohio Gas Company and Related Matters* (Oh. PUC, Apr. 25, 1996); Order in re: *Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market* (NY PUC, Mar. 28, 1996); Order in re: DPU 93-141-A (Mass. DPU, Feb. 14, 1996); Order in re: *Petition of Northern Indiana Public Service Company for Approval of Changes in its Gas Cost Adjustment Mechanism* (Ind. Util. Reg. Comm., Dec. 28, 1995); Order Approving Stipulation in re: *In the Matter of Accounting for Secondary Market Transactions by Natural Gas Local Distribution Companies* (N.C. Util. Comm., Dec. 27, 1995); Decision and Order in re: *New Jersey Natural Gas Company Compliance Filing for Unbundling of Natural Gas Services* (N.J. BPU, Oct. 19, 1994).

E. Petitioners

Petitioner Associated Gas Distributors (AGD) is a trade association composed largely of local distribution companies regulated by state commissions and engaged in the business of distributing and selling gas to commercial and residential consumers, typically within a given state. AGD's member companies operate in 18 states and the District of Columbia. AGD is joined in this Petition by three individual LDCs, each of which is acknowledged by FERC to come within the terms of the Hinshaw exemption.[5] As such, each is regulated by the States in which they operate and not by FERC. Their customers have purchased gas and need to have it transported to them, and naturally turn to LDCs for that service. The LDCs would, in turn — as they have always done — supply the transportation service, both through their own intrastate lines and through "capacity" that the LDCs have under contract with interstate pipelines. Under Order 636, the latter portion of the service that the LDCs would provide to their traditional in-state customers would be subject to FERC regulation, rather than to the comprehensive regulatory program established by the States over LDCs' services to in-state customers.

F. The D.C. Circuit's Decision Sustaining FERC's Action

Petitioners sought review of FERC's Order 636 to the United States Court of Appeals for the District of Columbia Circuit. Citing the restrictions of NGA Sections 1(b) and 1(c), they asserted *inter alia* that FERC's attempt to exercise jurisdiction over LDCs' sales of capacity rights to in-state customers unlawfully preempted exclusive state regulation of local distribution services.

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5. Those companies are: Atlanta Gas Light Company, Chattanooga Gas Company, and Northern Indiana Public Service Company.

The Court of Appeals panel affirmed, holding that FERC possessed the authority to regulate the capacity sales by LDCs to their in-state end-users, notwithstanding the provisions of NGA Sections 1(b) and 1(c). In so affirming, the Court of Appeals gave little independent weight or credence to the important state interests involved. Its discussion of these issues is limited to only a few pages. *See* 88 F.3d at 1151-53; Pet. App. A, 76a-82a, *as amended by* Pet. App. F, 1001a-1002a.

Focusing on NGA Section 1(b), the Court of Appeals declined to view the description of state authority in that section as an *exemption*. Rather, the Court of Appeals held that the grant of authority to FERC over interstate commerce, and the grant of authority to the States over local distribution, "are a unity." 88 F.3d at 1151; Pet. App. A, 78a (a view akin to that expressed by this Court in *East Ohio Gas* that it was "surplusage"). As "a unity," there was no need to consider the scope or importance of the assigned state powers. Rather, if the regulation in question fell within the definition of FERC's authority over transportation, that would be determinative because, under Section 1(b), the States possess only the authority *not* assigned to FERC. As the Court of Appeals characterized it, "NGA § 1(b)'s reference to 'local distribution' . . . does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of natural gas." 88 F.3d at 1153; Pet. App. A, 82a.

The court acknowledged that the NGA granted the States exclusive authority to regulate local distribution companies' bundled sales of natural gas to end-users. It held, however, that unbundling changed the analysis. Because the sale of unbundled capacity rights involves transportation in interstate commerce, it is facially subject to FERC's jurisdiction under the NGA to regulate interstate pipelines, notwithstanding that the transaction is between an LDC and its in-state customer. 88 F.3d at 1153; Pet. App. A at 82a.

The Court of Appeals remitted Section 1(c), the Hinshaw exemption, to a footnote, dismissing the provision on the same theory that it applied to Section 1(b): if there was apparent federal authority over the transaction as "interstate transportation," that was sufficient to override any claim of state exemption. *See* 88 F.3d at 1153; Pet. App. A at 82a; *as amended by* Pet. App. F, 1001a-1002a. Although Section 1(c) is phrased as an exemption from federal authority, *i.e.*, it defines the persons and activities Congress intended to be regulated exclusively by the States, the Court of Appeals gave it the same kind of "unity" analysis it applied to Section 1(b). The Court of Appeals, therefore, never considered the scope of the exemption under Section 1(c), its purpose, or its importance to state regulatory schemes. The fact that the transaction that FERC sought to regulate involved a sale by an LDC, subject to state regulatory control, to an in-state customer, did not weigh in the analysis.

The LDCs moved for rehearing and rehearing *en banc*, which prompted the modification to the footnote devoted to the Hinshaw exemption. *See* Pet. App. F, 1001a-1002a. The Court of Appeals denied rehearing. *See* Pet. App. G, 1003a-1004a; Pet. App. H, 1005a-1006a.

REASONS FOR GRANTING THE WRIT

Order 636 and the Court of Appeals decision work a fundamental shift in the division of state and federal authority over the regulation of natural gas. What had heretofore been a clear grant of state authority to regulate retail gas utility services by LDCs to in-state customers has now, to a significant degree, been preempted by FERC regulation of capacity sales by LDCs to their traditional customers. Because the clear intent of Congress under NGA Sections 1(b) and 1(c), the Hinshaw exemption, is to preserve the exclusive authority of the States to regulate LDCs services to in-state end-users, FERC's regulation cannot stand.

The Court of Appeals made a fundamental analytic error. It purported to determine the scope of federal authority under Section 1(b) of the NGA without first giving full force and effect to Congress' intention to preserve the constitutional authority of the States to regulate transactions involving local distribution companies and in-state customers. After this Court applied similar reasoning in *East Ohio Gas*, Congress made clear the error of that reasoning with the enactment of Section 1(c), which reinforces the exemption from the Act afforded to areas of state regulatory authority.

Under the NGA as originally written and as reinforced by Section 1(c), federal authority extends only to those areas that are not subject to state authority. A proper analysis required the Court of Appeals to look first at the natural scope of state regulatory authority under the Act. That review would determine what was left for the federal government to regulate. By focusing instead on the apparent scope of federal (rather than state) power, and treating the States as if *they* could regulate only what was left over, the Court of Appeals inverted the analysis and reached the wrong conclusion.

I.

PRINCIPLES OF FEDERALISM AND THE NGA ITSELF REQUIRE DEFERENCE TO STATE AUTHORITY IN DETERMINING THE PROPER SCOPE OF FEDERAL AUTHORITY.

Any inquiry into preemption of state law must begin with the "basic assumption that Congress did not intend to displace state law." *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981).[6]

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6. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 634 (1981) (" '[P]re-emption of state law by federal statute or regulation is not favored (Cont'd)

This "strong presumption against pre-emption" (*Cippollone v. Liggett Group, Inc.*, 505 U.S. 504, 523 (1992)) avoids "unintended encroachment on the authority of the States." *CSX Transp., Inc. v. Easterwood*, 113 S. Ct. 1732, 1737 (1993). The rule against preemption is strongest where the matter involves "a field which the States have traditionally occupied." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

Utility regulation is "one of the most important of the functions traditionally associated with the police power of the States." *Arkansas Electric*, 461 U.S. at 377. Because it is a " 'field which the States have traditionally occupied . . . . we start with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the clear and manifest purpose of Congress.' " *Pacific Gas & Elec. Co. v. State Energy Resources Conserv. & Dev. Comm'n*, 461 U.S. 190, 206 (1983) (quoting *Rice*, 331 U.S. at 230).

Congress sought to both embrace and embody this respect for the constitutional scope of state authority in the regulatory framework established by the NGA. To assume, as did the court below, that Congress intended to allow a federal agency to override state and local authority over entities historically and

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(Cont'd)
in the absence of persuasive reasons — either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained' ") (citations and internal quotations marks omitted); *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 86 (1987) (finding no preemption based on the frustration doctrine where a state law was "consistent with the text and the purposes of" the federal law at issue); *English v. General Elec. Co.*, 496 U.S. 72, 79 (1990); *see also BFP v. Resolution Trust Corp.*, 114 S. Ct. 1757, 1764 (1994) ("Federal statutes impinging upon important state interests 'cannot . . . be construed without regard to the implications of our dual system of government' "); *id.* at 1765-66 ("where the intent to override is doubtful, our federal system demands deference to long established traditions of state regulation").

comprehensively under state control, turns the constitutional presumption on its head.

Under the NGA, Congress established a regulatory regime that would "take '*no authority* from State Commissions.' " *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. at 610 (emphasis added). Congress made state regulatory primacy a matter of *federal* law, first under Section 1(b) and then again, even more explicitly, under Section 1(c).

Under the NGA, there are thus two separate, but *not* overlapping, spheres of regulatory authority: one sphere continues the exclusive prerogative of the States over local distribution, local distribution companies and retail service to in-state customers; the other sphere, occupying roughly the area in which the Commerce Clause bars state regulation, was assigned to the federal government. *Federal Power Comm'n v. Panhandle Eastern Pipe Line Co.*, 337 U.S. at 513; *see also Federal Power Comm'n v. East Ohio Gas Co.*, 338 U.S. at 478-83 (Jackson, J., dissenting).

The state-federal regulatory framework does not contemplate a broad federal power over natural gas distribution, with the States simply given residual authority over whatever the federal agency chooses not to regulate. To the contrary, the Act was founded on (and amended to reflect) the principle that, as the first order of business, the States were to retain their authority over local distribution companies and their services to local customers. It was the federal government that was assigned the "leftovers," filling gaps (created by the dormant Commerce Clause) on the *State's* power to act. *See* 338 U.S. at 478-83.

The court below failed to heed these concerns; indeed, the Court of Appeals did not even pay them lip-service. Rather, the

court reasoned that if the subject matter of the regulation colorably fell within the scope of the grant of authority to the federal agency, there was no need to consider the scope of the authority that the statute reserves exclusively to the States. By *only* crediting the federal claim to jurisdiction and its rationale, while disdaining the need for any serious inquiry into the scope of the authority that the NGA intended to preserve for the States, the Court of Appeals performed at best only half of the required analysis.

The Court's reasoning recalls the debate between the majority and dissenters in *East Ohio Gas*. *See* discussion, *supra*, at 5-7. As the dissenters pointed out in that case, once "we pay even lip service to Congress' intention to leave to the states that which they can regulate," it is impossible to address the scope of federal power without first considering the scope and nature of the power that Congress preserved for the States. 338 U.S. at 481.

Were *East Ohio Gas* the last word on the subject, the Court of Appeals' reasoning might have been understandable as an attempt to follow this Court's direction. *East Ohio Gas* was not, however, the last word, because Congress specifically moved to reinforce the *East Ohio Gas* dissenters' position with passage of NGA Section 1(c), the Hinshaw exemption. That exemption emphasizes Congress' original intent to preserve the scope of traditional state authority and protect it from federal intrusion. The exemption also tends to demonstrate that the majority was probably not reflecting Congress' will when, in *East Ohio Gas*, it construed Section 1(b), but failed to take full account of the purpose and scope of the state authority that Congress intended to preserve.

Regardless of the scope of Section 1(b), Section 1(c) stands on its own, as an exemption from the Act. At a minimum, it is improper to determine the permissible scope of federal power

without paying heed to the reserved power of the States over local distribution companies as reflected in Section 1(c).

II.

THE COURT OF APPEALS' REASONING DOES NOT CONFORM TO THE STRUCTURE OF THE NATURAL GAS ACT.

As explained above, Congress preserved the States' authority over the local distribution companies' services to end-users within the state. That service is the core of state regulation — a subject of regulation that was to be free from federal interference or overlapping control. It is a type of regulation that typically requires comprehensive authority over the retail sales of entities subject to that authority — here, the LDCs over which the States were granted authority.

The Court of Appeals held that because the transactions in question nominally fell within the scope of FERC's grant of authority over interstate transportation, that was all that needed to be determined; the States' residual authority was merely what remains after the federal agency exercises its power.

This is a familiar form of federal court reasoning. That reasoning will often make sense in a federal system in which the federal government has the Supremacy Clause to back up its actions, leaving States to fill gaps not occupied by exercises of federal power.

It does not make sense, however, where Congress itself has acted to preserve traditional state authority, as part of federal statutory law, allowing the federal government to regulate only in an area constitutionally barred to the States. Where traditional state authority has been statutorily preserved, state power stands

on at least equal footing with federal power. Here, the scope of state authority should have been the touchstone for determining the scope of federal authority because, under the NGA, the federal government exercises only the residual power *not* preserved to the States.

Any line of reasoning under which *only* the legitimacy of the federal interest and only the scope of the apparent federal power are considered, will invariably ratify an expansive notion of federal power. This Court, however, is presumably poised to stand guard against that line of reasoning where it is not consistent with Congress' intent.[7] Because of the way that the NGA is structured, and in light of its history, the perceived federal need for uniformity must give way to the primacy of state regulation as guaranteed by the Act. This is not because of some inherent constitutional principle, but because that was precisely what Congress intended and established under the NGA.

Although we do not rely on the Tenth Amendment here, we note that the jurisprudence that has developed in connection with the Tenth Amendment serves to illustrate the error in FERC's and the Court of Appeals' reasoning.

There has, of course, been a fair amount of debate about

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7. Similar efforts by federal agencies to redefine their jurisdiction in relation to that of state agencies are pending in the communications and electric power industries. *See* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 (Aug. 8, 1996), *stay granted*, *Iowa Utils. Board et al. v. Federal Communications Comm'n*, 1996 WL 589204 (8th Cir., Oct. 15, 1996); Order No. 888, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services By Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Docket Nos. RM95-8-000 and RM94-7-001 (Apr. 24, 1996), slip op. at 400-42.

whether the Tenth Amendment's reservation of powers to the States, where not assigned to the federal government, provides an enforceable limitation on the exercise of federal power. One school of thought suggests that this Amendment impliedly reserved to the States some definable powers, immune from federal regulation.

But another school of thought, drawing support from the precise wording of the Tenth Amendment, says that *all* that was reserved to the States was the power that the federal government was *not* assigned. Under this line of reasoning, all that need be determined is the scope of the assigned federal power. State authority has no independent vitality; it consists only of what remains after the broadest reach of federal authority is determined.

However apt that line of reasoning in other circumstances, it does not fit the NGA. Congress has chosen to grant primacy to the natural reach of state power and barred the federal government from invading the States' domain. In fact, the history of the Hinshaw exemption suggests that it was specifically enacted to overcome the tendency to define federal authority solely by looking at the words of the federal grant of power; the Hinshaw exemption reaffirms that the state grant of power over LDCs and their sales and distribution to retail customers must be respected, irrespective of a colorable grant of federal authority over the subject of the transaction. *See* discussion, *supra*, at 5-7. It is, therefore, impossible to understand the scope of federal authority without first addressing the intended scope of state authority, giving state authority the full play to which it is entitled under the statute as conceived. Once that is done, federal power is free to operate in the residuum *not occupied by the States*.

The Court of Appeals never did construe or consider the intended scope of state authority. Because it did not do so, it misunderstood the scope of federal authority under the Act.

III.

THE TRANSACTIONS IN QUESTION COME WITHIN THE AUTHORITY RESERVED TO THE STATES.

As pointed out above, over the last fifty years, there has been relative stability about the respective roles of state and federal authority over the natural gas industry. The States' authority over LDCs and their transactions with in-state customers has been left largely undisturbed by FERC. The time-honored understanding of the proper division of state and federal authority under the NGA has been put in play by FERC-initiated changes to the way that natural gas and natural gas services are marketed.

"Unbundling" amounts to a FERC-imposed change in what is actually being sold. It marks a shift from the sale of natural gas as delivered (with all the costs of transportation and purchase at the well-head built into the ultimate price), to the resale of LDC-contracted pipeline "capacity" to be used for the transportation of natural gas that an LDC's in-state customer can now, practically, purchase from a marketer or producer. While the statutory language cannot fit this new scheme of marketing with the same precision as it did the old, the statutory language still fits LDCs and their service to in-state end-users.

More importantly, where the language of the statute is no longer geared precisely to real world conditions — here, the real world of natural gas marketing under FERC's restructuring of the industry — the objective of a reviewing court should be to insist that the statute be administered consistent with the basic structure and purpose of the plan as originally conceived. Here, FERC ought not be able to use the basic shifts in market that it has itself created in order to bootstrap itself into a position of authority over transactions at the core of the States' authority.

Maintenance of a cohesive state regulatory regime over LDCs and their relations with in-state customers is central to the preservation of state regulatory authority.

The Hinshaw exemption mandates that the provisions of the NGA shall not apply to persons (a) engaged in either the interstate transportation of gas or the sale for resale of gas; (b) receiving gas at or within the boundary of a State, where "all the natural gas so received is ultimately consumed within such State"; and (c) whose rates, services and facilities are "subject to regulation by a State commission." *See* NGA § 1(c), 15 U.S.C. § 717(c). LDCs are such "persons." Section 1(c) also provides that a certification is "conclusive evidence" of the States' regulatory jurisdiction. The plain language of NGA Section 1(c) says that "the provisions of the NGA shall not apply to any persons" that come within its terms. Thus, LDCs are *not* persons that FERC can subject to the provisions of the NGA.

FERC has never contested that most LDCs come within the terms of NGA Section 1(c). The Court of Appeals, however, never even addressed the issue because it mistakenly believed that if the regulation fell within FERC's apparent grant of regulatory authority over interstate commerce, that was sufficient to override state authority.

Even if the language of NGA Sections 1(b) and 1(c) no longer provide a perfect fit with the restructured market, the division of power under the new regime must parallel the basic structure of regulation embedded in the Natural Gas Act. The basic structure of the Act contemplates that the States would regulate transactions between LDCs and their in-state end-users as part of a comprehensive scheme of intrastate regulation. The objective was to leave regulation of LDCs entirely in the hands of the States. The nature of state regulation of LDCs in order to serve in-state customers requires comprehensive control over all such transactions.

The court below held, in effect, that the transaction between the LDC and the local customer could be subjected to federal control because the "unbundled" service that was the subject of the intrastate transaction had an interstate nexus. It offered no explanation why — in terms of the purposes of NGA, the purpose of the exemptions, and the nature of the historic power of the States which Congress sought to preserve — unbundling should remove such transactions from exclusive state authority. Rather, the Court of Appeals focused only on the federal grant of power, FERC's objectives and FERC's reasons for subjecting such transactions to federal control.

There can be little suggestion today that the States cannot regulate a contract between a local distribution company and its in-state customer, involving gas to be consumed within the State. The fact that the subject matter of the contract involves, in part, interstate transportation of gas would not place the contract between LDC and the in-state customer beyond the States' authority.

To be sure, the issue presented here revives, in some measure, the debate between the majority and the dissenters in *East Ohio Gas*. That was a debate over whether the States' powers, preserved by Section 1(b), should be construed consistent with (what is now) 60-year-old case law under the dormant Commerce Clause, or measured by more modern constitutional standards to reflect Congress' respect of state authority. *See* discussion, *supra*, at 5-7. In Petitioners' view, Congress' original intention to preserve the primary role of the States supported the dissenters in *East Ohio Gas*. But the issue presented in the instant case would *not* simply be a rehash of old problems: to the contrary, enactment of Section 1(c) necessarily changed the statutory framework and requires the Court to renew its attention to this area.

The form of state regulation that Congress sought to preserve contemplates a *comprehensive* scheme of rate control over LDCs. Such regulatory regimes require consistency and exclusivity of control over LDCs' relationship with their local customers, whether the transaction in question involves a sale of "bundled" natural gas for use within the State, or unbundled segments of a total package of services that results in the delivery of natural gas for use within the State (and which the in-state customer is purchasing in lieu of a purchase of "bundled" natural gas.) The comprehensive structure of the state programs are thus defeated by subjecting LDC capacity sales to federal control.

Whereas FERC clearly favors a nationwide, uniform approach to sales and resales of capacity, the fundamental premise of the grant of authority to the States was that there would be, or could be, variation between States reflecting the use of the state regulatory program to serve local objectives.

IV.

FERC'S PREEMPTIVE RULING FUNDAMENTALLY DISRUPTS STATE REGULATION OF NATURAL GAS UTILITIES.

As should be clear, this petition presents no challenge to the concept of "unbundling" or the overall objectives of the federal plan. Rather, it concerns only the question of ultimate control over one aspect of the current market structure, the resale of capacity by LDCs to in-state customers. That part of the market is a small part of the federal program, but is a core component of the state regulatory framework. That framework will be disrupted by FERC's assertion of authority over these LDC transactions.

Congress clearly intended that state policies, and the objectives of the state regulatory scheme, prevail in this area of historic state authority over LDCs and intrastate customers.

A. The Problem Created By Piecemeal Regulation Of LDC Service

For state regulators, LDC capacity release service to local customers is simply one element of a larger program whereby LDC services to gas consumers are unbundled. These unbundled services stand in lieu of earlier sales of "bundled" gas to those same customers.

Generally speaking, state regulatory agencies share the perception that the LDC unbundling process is an important, strategic step in the direction of achieving the goal of consumer economic protection in a more competitive energy marketplace. But those agencies also understand that LDC capacity release is a means by which the gas consumer that has acquired its own gas supplier can be certain that this gas will be transported through the existing interstate gas transportation facilities for delivery to its local gas utility's system. In other words, more and more gas consumers are now *not* purchasing gas from the LDC. But the gas consumer still finds it convenient to obtain the transportation necessary to bring the gas to it — through distribution lines outside the state and inside the state — from the LDC, just as always.

For its part, FERC sees LDCs' resales or assignments of capacity to in-state customers as simply one part of its nationwide market structure. LDCs' transactions with in-state customers are not — so far as FERC is concerned — entitled to any special consideration. FERC thus views LDC capacity release to in-state customers as influencing or determining which customers will have how much access to the LDC's interstate

pipeline supplier's capacity and at what price; thus, the LDC is seen as allocating interstate pipeline capacity, just as interstate pipelines do. FERC seeks to maintain exclusive control over the selection of pipeline capacity users and to assert control over LDC's capacity assignment transactions, even where such transactions involve an LDC's effort to serve its traditional local customer.

B. State And Federal Objectives Conflict

The basic objective of federal regulation of LDC capacity release transactions is to make interstate capacity available to the highest bidder, wherever located. This objective is achieved by the mandate that any release proposed at less than the ceiling rate be subject to an auction process so that any party, whether or not located within the LDC's service area, can acquire an LDC's capacity by offering the highest bid for it. Thus, for the FERC, an LDC's resale to its traditional in-state customers of the capacity rights that it has previously purchased is just one more sale of transportation, no different from any other. FERC seeks to subject all such sales to its authority.

State regulatory objectives focus on service to local customers and the melding of the opportunities created by "unbundling" with the comprehensive regulatory system focusing on *state* energy policy. In most cases, state goals include consumer economic protection and reliability of service. These goals are not inconsistent with unbundling, but they require that the States be able to address the provision of unbundled service as part of the overall regulation of LDCs. Thus, state regulation of LDC capacity release may be an important component of a *state* unbundling program designed to provide state gas consumers with both the economic benefits of a more competitive natural gas marketplace *and* reliable gas utility service.

For example, in some States, the unbundling program includes an LDC capacity release involving *blended* capacity releases. In such a plan, the gas transportation occurring upstream of the LDC's intrastate facilities is deemed to be provided in part by each of the LDC's pipeline suppliers rather than exclusively by any particular pipeline company. The blending approach avoids the arbitrary allocation of the more expensive pipeline transportation service to any specific customer or customers, and likewise, the allocation or assignment of the least costly pipeline capacity to specific consumers. Such a plan is designed to broadly provide the benefits of unbundling to all state customers, without creating great disparities among in-state customers on price and service. However, such a blended approach is simply not compatible with Order 636, which requires that a particular increment of an LDC's capacity rights on a particular pipeline be released to the highest bidder.

The pipeline capacity that LDCs now have available for capacity sale has been acquired by LDCs to service their customers and has typically been reviewed by state regulators with these ends in mind. Thus, the rates that have been set have allowed those purchases for the benefit of in-state customers, as part of the state regulatory program. At bottom, however, it is the objective of the federal program to allow capacity sales to the highest bidder, wherever located. The result is that in-state customers may never be allowed to benefit from the investment they made in LDC capacity.

C. Customer Choice Initiatives

In light of the restructured market promoted by FERC, a growing number of the LDCs filing this Petition are now offering to more of their customers the opportunity to choose among gas

sellers.[8] This trend is expected ultimately to reach most U.S. residential gas consumers.

As these customer choice programs are implemented in the various states, gas consumers selecting new retail gas sellers confront the need for transportation service from their LDC. As they do so, they can be expected to make use of the gas transportation facilities already in place, including interstate pipeline facilities made available through some form of capacity release transaction with their LDC. The access of these consumers to their newly acquired gas supply source on an *economical and reliable* basis may well depend on whether their LDC is subject to a comprehensive, coherent state regulatory program or whether, instead, it is subject to both state and federal regulatory authority designed to achieve different and sometimes conflicting objectives. Thus, protection of consumers, including economical access to "unbundled" gas, may very well turn on the efficacy of state regulatory control, rather than piecemeal federal control of capacity release by LDCs to in-state customers.

* * *

The court below emphasized that FERC perceived the extension of its authority to LDC capacity resales to be part of a national program, serving federal reform efforts in the natural gas industry. As shown above, however, Congress intended to afford state regulators primacy with respect to the relationship between LDCs' and their in-state customers. Those intrastate contracts and relationships, involving the delivery of natural gas within the state, are subject to state control, notwithstanding that their subject matter involves the movement of gas in

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8. In most states where customer choice of gas seller has been widely offered, that opportunity has first been provided on an experimental basis through a "pilot program." *See* report cited at note 3, *supra*.

interstate commerce. Under the NGA as written, the federal program of control over the natural gas industry must acknowledge its statutory limits and accommodate state control over that relationship.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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